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FINAL PROGRAM REPORT OF ACTIVITIES
for the
ECONOMIC AND COMMUNITY REVITALIZATION ACTIVITY

October 1, 2001 – April 15, 2004

Submitted to:



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April 2004

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Program Overview

Implementing Partner:	FLAG International, LLC (FI)
Title of Project:	Increased Sustained Returns in Economically and Socially Revitalized War-Affected Areas Economic and Community Revitalization Activity MC - ECRA (Cooperative Agreement No. 160-A-00-01-00103-00) Sub-grant no. CR-02
Dates of Project:	October 1, 2001 – April 15, 2004
Project Director:	Daniel Gies FLAG International, LLC Kralja Zvonimira 2 22300 Drnis, Croatia
Project Funds Allocated:	\$1,875,568
Total Number of Beneficiaries since previous QPR:	55
Total Number of Beneficiaries during the entire grant period:	1147
ECRA Municipalities:	Donji Lapac, Kistanje, Drniš, Obrovac, Pakrac, Kostajnica, Dvor
Budget Modifications Approved During Grant Period:	Modification 01 – Wood Processing Revitalization Analysis Modification 02 – Expansion of activities to Drnis and Obrovac, introduction of Livestock Credit Program (LCP) Modification 03 – Commission of livestock market study in Gvozd Modification 04 – Expansion of LCP to Dvor, Pakrac, and Kostajnica Modification 05 – No-cost Extension for LCP monitoring
USAID Strategic Objectives Supported by FI under the ECRA Program:	SO 3.1 <i>“Accelerated Return and Sustainable Reintegration of the War-Affected Populations”</i>
USAID Intermediate Results Supported under The ECRA Program:	IR 3.1.2: <i>“Community-based economic programs that create jobs and outputs”</i>

1. Introduction

This is the final program report of program activities implemented by FLAG International LLC (FI) under the Economic and Community Revitalization Activity (ECRA). ECRA is an umbrella grant program administered by Mercy Corps International using funds provided by the United States Agency for International Development (USAID). The ECRA program supported the operations of several implementing partners in the delivery of an array of socio-economic, legal and other services to client communities in order to address the multifaceted problems that hinder the development of these communities. ECRA was launched to support USAID **Strategic Objective (SO) 3.1** “*Accelerated Return and Sustainable Reintegration of the War-Affected Populations.*”

FI was awarded a subgrant from Mercy Corps on October 1, 2001 for the purpose of spearheading economic and agricultural enhancement measures under the ECRA program in the war-affected municipalities of Donji Lapac and Kistanje. Program activities were designed to support USAID **SO 3.1** and **Intermediate Result (IR) 3.1.2** “*Community-based economic programs that create jobs and output.*” The tools used by FI to support these goals were firm-level technical assistance, the development of community-based projects, and the implementation of a Livestock Credit Program (LCP) for agricultural producers in the ECRA areas.

FI implemented technical assistance programs to assist residents in forming sustainable agricultural cooperatives, provide firm-level technical assistance to Small and Medium Enterprises (SMEs), strengthen business associations, and develop community-based economic development projects. Subsequent to the original grant, Mercy Corps approved five modifications to program activity. Budget modifications 02 and 04 expanded the scope of FI activity to cover the municipalities of Drniš, Dvor, Hrvatska Kostajnica, Obrovac, and Pakrac, and introduced an innovative Livestock Credit Program (LCP) that encouraged the rejuvenation of local livestock herds and enabled beneficiaries to attain sufficient livestock levels to transition from subsistence to commercial farming. Additional budget modifications financed a wood processing revitalization analysis (Modification 01), a feasibility study for a livestock market in Gvozd (Modification 03) and a no-cost extension of the LCP program in order to transfer program activities and loan funds to the DEMOS Savings and Loan Cooperative (Modification 05).

FI’s economic development activities under the ECRA Program resulted in significant income increases for the direct beneficiaries of FI assistance. Employment and income generation activities increased the stability of rural communities and encouraged the development of the local economies. The results achieved by the FI team over the past two years have been remarkable given the severe financing and investment constraints that exist in Croatia’s war-affected areas. The development of profitable investment opportunities and the rate of economic progress in rural Croatia continue to be undermined by the lack of human and financial capital, weak enforcement of legal contracts, scarce loan collateral and resulting limited credit opportunities. However, ECRA activities in the partner municipalities resulted in income increases and improved business opportunities for many citizens.

As a testament to the effectiveness of program activities, FI exceeded ECRA performance indicators by significant margins (see Indicator Table, below). FI developed numerous creative solutions to overcome many of the difficulties affecting ECRA clients. By focusing on selected product clusters, creating market linkages with processors and facilitating financial inputs, FI’s assistance resulted in the direct creation of jobs for 246 individuals. This achievement is 14% higher than the targeted level of performance. The total, however, belies the true employment impact in Croatia’s economically depressed areas. The substantial increase in the income level of direct beneficiaries has created positive indirect income and job effects for non-beneficiaries, thereby increasing the general level of economic activity in the communities as a whole.

By delivering firm-level technical assistance to increase the profitability of SMEs and cooperatives with the highest potential for development, FI assisted in creating sustainable business entities that will continue to flourish after the close of ECRA. FI worked extensively with food processors in order to improve supply relationships with small farmers working in ECRA municipalities, resulting in mutually beneficial trade relationships between the small-scale producers and value-added processors. Agricultural cooperatives have been established and strengthened to provide a mechanism for small farmers to gain income, improve market access, and access additional financial inputs that would not have been possible; the direct and visible income advantages provided to members create a positive incentive structure that is consistent with membership growth. Support provided by FI to economic entities has helped to improve the local economic environment by encouraging greater compliance with Croatian law. FI has worked to promote the proliferation of forward contract agreements that encourage investment by reducing the risks and uncertainties of conducting business in underdeveloped areas.

ECRA Summary Indicator table:

FI Program Performance Measured Against Targeted Performance Levels:

Performance Indicator	Performance Target	Actual Achieved by End of Project	Target Achieved	Target vs. Actual
(1) Number of individuals <i>employed</i> in ECRA assisted individual enterprises	215 individuals employed	246 individuals employed	Target Exceeded	+14%
IR 3.1.2.1 INDICATORS:				Target (\$) vs Actual (\$)
(1) Value of sales contracts concluded by ECRA assisted producers, firms, producer associations and cooperatives.	75 contracts concluded; Total value: \$567,000	78 sales contracts concluded; Total value: \$776,627	Target Exceeded	+37%
(2) Number, source, and value of loans/ financial inputs received by business clients/enterprises since ECRA.	30 inputs; Total value: \$213,000	78 inputs; Total value: \$893,229	Target Exceeded	+319%
Cost Share and Community Contribution	\$508,059	\$1,064,362.74	Target Exceeded	+109%

This report outlines our methodology, results, lessons learned and other aspects of implementation during the period of FI's ECRA grant. Section 2 describes our implementation methodology; Sections 3 and 4 describes the results achieved; while sections 5 to 11 provide additional information to Mercy Corps on the details of our technical approach.

Program Implementation Methodology

1.1 Client Approach

FI's efforts to promote the development of economic activity in ECRA municipalities take into account the unique conditions and the complex web of problems facing businesses that operate in these areas. Rural areas of Croatia are not only characterized by limited economic opportunities, but also massive uncertainty as well as social cohesion issues such as a lack of trust.

FI's approach emphasized the importance of long-term client relationships and a regular presence in the local communities. A regular presence was helpful in order to identify local economic opportunities with the highest potential and earn the trust required for a successful relationship with clients. Instead of working directly with individuals, FI worked to identify common problems and establish an appropriate cooperative or association structure for individuals to address mutual concerns. In economically depressed rural areas, many potential clients are small-scale agricultural producers with limited production volume and lack of business savvy. Cooperatives and associations create a structure for the producers to overcome the problems imposed by small scale production.

1.2 Implementation Methods

The primary tools employed by FI in advancing the goals of the ECRA program included:

- Direct **firm-level technical assistance to SMEs** operating in war-affected areas to improve access to finance, establish market linkages and create employment opportunities for local residents.
- **Competitiveness enhancement** activities aimed at empowering local enterprises to make dynamic adjustments to changing market conditions and increasing cost efficiency. An example of this work includes the direct assistance provided to the formation of the Drnis Prsut Association and the restructuring that has shifted their focus to premium pršut that provides these SMEs with a competitive advantage in the marketplace.
- The delivery of **management consulting services** aimed at improving cost competitiveness and the formalization of a concrete and realistic strategic vision on the part of recipient beneficiary organizations.
- The **development and strengthening of business associations and cooperatives** that provides sustainable legal entities for businesses with similar concerns to work together for the resolution of common problems. An example includes the Zagora Agricultural Cooperative of Drnis that has assisted 561 farmers in Drnis and surrounding municipalities to access state subsidies and additional income from the sale of milk to the I-Pak dairy.
- The **implementation of a Livestock Credit Program (LCP)**, an innovative method of delivering microfinance in ECRA areas to help accelerate the reestablishment of market linkages and the restoration of livestock herds to pre-war levels. The program has loaned 2,325 animals to over 70 emerging commercial agricultural producers, substantially increasing sustainable income levels for these farmers.
- The **development of community-based projects** to strengthen linkages between business investments made in ECRA municipalities and community residents, thereby increasing the impact of these investments on the economic revitalization of local economies.

- The **operation of a network of 5 local Business Development Centers (BDCs)** that have served as **clearinghouses for business information** related to debt-financing opportunities, financial inputs, and other business services relevant for the promotion of SME growth and general economic activity in ECRA municipalities. These BDCs have also served as a vital point of contact for FI to maintain a presence in local communities, establish client relationships and more efficiently deliver assistance to clients in ECRA municipalities. BDCs were maintained in the municipalities of Donji Srb, Obrovac, Dvor, Drniš and Kistanje.



1.3 Establishing Market and Trade Linkages

A BDC in Donji Srb

FI activities in Croatia have proven the effectiveness of working through cooperatives and business associations to implement our market-linkage/finance-facilitation approach. Rural economic development programs often tend to promote income growth by emphasizing measures to increase production of agricultural goods for individual producers. Yet, the increased production generated typically does not result in increased income because the producer cannot identify a buyer to purchase the expanded output. FI instead focuses efforts on: 1. establishing cooperatives and business associations to provide a vehicle for common problems to be addressed; 2. developing the capacities of these groups to facilitate larger scale trade of goods for its members; 3. creating long-term market linkages with value-added processors at improved terms of sale; and 4. facilitating the acquisition of investment-oriented financial inputs through the cooperative or association.

The cornerstone of the approach is the establishment of lasting trade relationships between raw material producers and value-added processors that convert the raw materials into finished goods. The forward sales contracts negotiated are mutually beneficial because they stabilize the processor's supply of raw materials while at the same time adding income through a better price for producers that are members of a cooperative or other producer group. Without these forward contracts, rural producers tend to individually find the best price for their goods at the time of sale, which does not



help to establish a long-term client relationship and results in higher costs of doing business due to the search time required to find a buyer for goods. As a consequence, processors are often unwilling to deal with small-scale producers because they cannot be assured of the quality, quantity and price when the production input is needed. The result is that the processors often operate below capacity, producers obtain a lower price in the long run for goods because they do not have a direct relationship with the value-added processor, and both sides incur unnecessarily high transaction expenses. Forward contracts between producer groups and processors help to reverse this wasteful, growth inhibiting cycle.

1.4 SME Investment Promotion Finance Facilitation

Stabilized raw material supplies for SME processors and guaranteed sales channels for producers provide an incentive for both groups to invest in expanded production. FI facilitated access to debt and grant financing for SMEs, cooperatives, associations and members that are active in these

producer groups. For example, the Eko-Dalmacija Agricultural Cooperative of Kistanje is currently constructing an oil processing facility that will enable producers to greatly increase the profit earned from the production of almonds and olives.

Focusing on the delivery of services to high value-added processor SMEs in the war-affected areas, and improving linkages between such these processors, purchasers of finished products, and providers of raw material inputs, has achieved significant gains for entities operating at each stage of the production cycle. By working with value-added intermediate processors to expand sales opportunities for products, the increased demand for the finished goods has expanded the processor's appetite for raw material inputs. This creates jobs for farmers and also positively affects the processor's demand for labor. As such, the investment facilitation typically resulted in the creation of jobs commensurate with the expanded production capacity or increases in the demand for raw materials.

1.5 Developing SMEs, Cooperatives and Business Associations

FI allocated significant resources to promote entrepreneurship in rural areas of Croatia. Small-scale agricultural production can do little to raise incomes in rural areas unless producers band together to form producer groups that have a larger production volume with which to negotiate with processors. Businesses working alone typically do not have the negotiating clout or savvy to advocate for issues on behalf of the greater business community at large. To ensure the sustainability of technical assistance, market linkages and finance facilitation services, FI has consistently encouraged the development of cooperatives and business associations as a model for promoting community-based economic development.

1.6 Effectiveness

Including the budget modifications submitted to Mercy Corps, the results to be accomplished by the end of the program included: creation of 215 jobs; completion of two Economic Development Plans; conclusion of 75 contracts related to the development of linkages with suppliers, processors and/or sources of grant/debt financing; and 30 business entities gaining access to loans/financial inputs and/or concluded contractual producer/buyer partnerships. By using the methodologies outlined above, **FI has exceeded these performance indicators as well as achieving over \$1 Million in documented cost share.**



2. Major Program Accomplishments

- Over **246** jobs directly created in ECRA municipalities;
- **Four Economic Development Plans** completed for ECRA Municipalities;
- **78** sales contracts concluded at a total value of over **USD 776,000**;
- **78** loans or other investment inputs for a total value of **USD 893,000**;
- Over **USD 1,064,362** in documented cost share achieved.

2.1 Prsut and Swine Herd Revitalization Program

Client(s): Drnis Prsut Producers Association, Agro Natur Cooperative, Bagen Cooperative,

Municipalities Affected: Drnis, Dvor, Pakrac, Hrvatska Kostajnica

Program Summary: The traditional Drnis Prsut industry has been restructured, reoriented and revitalized, providing the basis for the product to regain world-wide recognition and compete effectively on international and domestic marketplaces. The Drnis Prsut Association was formed with FI assistance and all 14 pršut processor SMEs that are members of the association have benefited from the FI's competitive-enhancement innovations.

Program Results Summary: Competitive revitalization of pršut producers have secured the market niche of high value-added premium pršut which will add jobs to the Drnis area in the long run; market linkages established to pig breeders in northern ECRA municipalities have secured high-quality raw material supplies for the pršut processors and expanded income opportunities for pig breeders.

Summary of Assistance Delivered by FI under ECRA:

- **Conducted a major market assessment** of the Croatian Prsut industry on behalf of the Drnis municipality and local pršut processors to identify problems threatening the survival of local pršut processors;
- Delivered technical assistance and encouragement that resulted in the **establishment of the Drnis Prsut Association**, providing a framework for members to address common problems;
- On the basis of the results of the market assessment, convinced **Association members to compete on quality, not price**. This shifted members' focus to the production of premium pršut and away from a doomed strategy to undersell high-capacity foreign competitors;
- **Provided marketing, brand assistance, development of a web site (<http://www.drniski-prsut.com/>) and support at trade fairs** to enable Association members to professionally present their products to customers;
- **Demonstrated best practice to Association members** during a study tour to the Parma Prsut Association in Italy, one of the most famous pršut producers in the world;
- Delivered technical and legal assistance that resulted in **Association members being awarded PDO certification**, the highest level of geographical origin protection that exists. PDO certification will protect the producers against competition from low-quality imports that had been falsely labeled as Drnis Prsut;
- Delivered education and training that will result in the Association receiving **ISO 9001 certification** and members receiving **Hazard Analysis and Critical Control Points (HACCP) certification**. These quality control standards are essential for the Association to reach larger distributors and export markets;
- **Established market linkages** with pig breeders, slaughterhouses and government entities that have resulted in lower input costs and a stabilization of the Association's formerly problematic supply of raw materials. In addition, these linkages have **provided access to a purely domestic source of pigs**, making it possible for PDO certification to be awarded;
- **Implementation of an innovative microfinance program**, the Livestock Credit Program, which loaned 900 high quality pigs to breeders along with a forward sales contract with the Prsut Association members that, guaranteed the sale of raw pršut at a premium price. The pilot project provided increased access to high-quality inputs for the association and simultaneously mitigated uncertainty for the breeders, making it feasible for them to raise the pigs according to the requirements of premium pršut.

Program Background and Results:

The production of traditional smoked ham (pršut) is a longstanding custom in Driš. Driš pršut is arguably the most famous smoked meat product in Croatia and has gained some recognition outside of Croatia. In fact, Driš Prsut is reputed to have been the favored pršut of royalty in Austro-Hungarian Empire and was served at the coronation ceremony of Queen Elizabeth II. Local climate conditions add a unique taste to the traditional drying and smoking of meat in the Driš area. A cold winter wind called *Bura* periodically drifts in from the Bosnian mountains adding a special flavor to the meat over the 1-2 year period required to dry pršut. These climate conditions give traditional Driš pršut a distinct quality that has long been regarded as among the finer delicacies available in Europe.



The wars that lead to the dissolution of the former Yugoslavia left the Driš meat processing sector in ruins (see “Revitalization Analysis and Recommendations for the Driš Prsut Industry” in the Appendix). Prior to the conflict, the state-owned company Mesopromet produced thousands of pieces of pršut per year. The Driš facility was an engine of the local economy, directly providing several hundred jobs, while allowing local pig breeders to earn a living by supplying raw materials to Mesopromet. Over 25% of Croatian pršut production came from Driš before the war. However, during the war, Mesopromet was completely razed. Under the ECRA Program, Driš municipality officials requested that FI investigate measures to restart the Mesopromet facility. The analysis indicated that a massive investment of over USD 10 million dollars would be required just to make the facilities operational. Mesopromet was also mired in a lengthy and complicated privatization process that to date is still unresolved. A further complication was provided by recent changes to Croatian environmental law, which would make it nearly impossible to restructure the existing facilities to be compliant with the more stringent ecological standards required for Croatia to be able to eventually join the EU.

Attention was shifted to SME pršut producers in the Driš area. These smaller facilities had a combined pršut processing capacity 75 percent larger than Mesopromet, had clear ownership structures, little or no war-related damage and were already functional. However, despite their high potential these SMEs were barely operational and faced significant impediments to growth. Producers lacked financing, had cash flow problems, operated at about 70 percent below capacity, lacked sufficient supplies of quality raw materials, did not meet quality standards, and had poor access to markets. Moreover, they faced fierce price competition from low-quality ham imported to Croatia or exported throughout Europe that was falsely labeled as Driš Pršut.

Individually, the Driš pršut producers tried to compete with imports on price by using cheaper raw materials – a desperate strategy doomed to fail given the larger production capacities and favorable production costs of their foreign-based competitors in Austria, Hungary and the Netherlands. On all of these fronts, the producers simply were not competitive and were slowly being crushed by rapidly changing market conditions as Croatia moved closer to membership in the EU.

Technical assistance was delivered to a group of 14 local pršut-producing SMEs to assist the formation a business Association, the Driš Prsut Producers Association, which provided a basis for them to work together to address common problems. The Association created a common identity among the producers, helping them to realize that their main competitive threats came from foreign-based producers, not the local peers that they futilely fought to undersell.

The Drniš tradition of high-quality production and local climate conditions were the main assets of the Association members, but to capitalize on these strengths the Association would need a more modern approach to the market. FI helped the Association to create a brand label that would ultimately become a way that consumers could identify genuine Drniš Pršut. FI also worked to transform the members' primitive packaging to provide a professional-looking, sanitary and tasty look for consumers. With other marketing material such as a web page and brochures, FI helped transform the Association members' approach to their clients.

FI pushed Association members to stop trying to compete on a price basis with high volume, low-quality importers and shift their focus to the production of a premium product. Premium pršut commands a much higher price in the marketplace in Croatia and Europe. Instead of procuring pork inputs from the cheapest purveyors in Hungary and Italy, FI helped the Association to identify pig breeders in Croatia's Slavonia region who raise domestically bred high-quality pigs under the optimal conditions for use as pršut inputs. By establishing a market link between pršut producers and pig breeders, FI helped to facilitate the Association's shift to a premium product and helped to stabilize the previously problematic source of raw materials for the producers. In addition, by developing an innovative Livestock Credit Program (LCP) that provided the breeders with the short-term financing needed to raise pigs to the Drniš Pršut Association's specifications, FI helped to resolve the tight cash flow cycle problem caused by the long production cycle that creates a painful lag between the purchase of raw pršut and the sale of the final product. This one-time LCP pilot project provided positive cash flow to both breeders and pršut processors, providing increased flexibility to finance production growth in subsequent years.

Creating a domestically-produced product enabled the Association to work with FI in gaining Protected Designation of Origin (PDO) certification. This designation recognizes Drniš Pršut as a unique product produced only in Drniš. It makes it illegal for importers to label their product as Drniš Pršut as had been the practice for the majority of pršut imported to Croatia. Eliminating fraudulent packaging has helped to undercut the competition's unfair advantage and started a process that will help to protect Drniš producers from grey market production and illegal imports that make up the overwhelming majority of pršut sold in Croatia.

FI sponsored the Association and several members to obtain, respectively, ISO and HACCP international quality control standard certifications. These certifications will ultimately enable Association members to export pršut throughout Europe and establish market linkages with large-scale distributors that require such certifications for meat products.

FI also supported members on a study tour to the Consorzio del prosciutto di Parma, and the Institute of Parma Quality (IPQ) in Parma, Italy. The trip helped members to shape their own vision for future development by showing them an example of an organization that has succeeded in gaining worldwide acceptance of their product by focusing on traditional production methods. The Drniš Pršut Association and the Parma Institute have agreed to work together to advocate for regulatory reforms that would help to keep traditional food production methods alive in Europe. The Parma model provided an exceptional blueprint for Drniš pršut manufacturers to reference as they move forward in promoting and protecting their brand franchise. The trip gave Drniš Pršut Association members valuable, first-hand exposure to an organization that many years ago addressed the issues that Drniš producers were ultimately able to tackle with assistance from FI.



2.2 Organic Food Production Development

Client(s): *Eko-Dalmacija Agricultural Cooperative and local farmers*

Municipalities Affected: *Kistanje and surrounding municipalities*

Program Summary: Delivered technical assistance, created market linkages and secured significant financial inputs that led to the establishment and development of the Eko-Dalmacija Agricultural Cooperative of Kistanje, one of the first business initiatives in Croatia specializing in the production of organic agricultural products. FI's finance facilitation and market linkages assistance in support of this SME have resulted in increased income and employment for residents of Kistanje and surrounding area; jobs have been created for both agricultural producers and staff to manage the cooperative and processing activities.

Program Results Summary: Organic production cooperative established in December 27, 2002, membership growth supported to current level of 57 members and cooperants, FI finance facilitation support results in nearly **USD 98,000** in financial inputs.

Summary of Assistance Delivered by FI under ECRA:

- Technical assistance delivered in cooperation with UNOPS resulted in the **establishment of Eko-Dalmacija** as a legal entity and helped start the process of gaining organic certification for products. For many local farmers, the Eko-Dalmacija cooperative provided both the first opportunity to operate within the legal economy and also an organization structure to support the production and distribution of high value-added products;
- **Market linkages established that provided the cooperative with forward contract relationships** and a guaranteed buyer for products. These contracts provided an initial income opportunity that helped to strengthen the cooperative and provide income for financing future development. The contracts also provided the basis for a long-term relationship with the SMS food processor in Split that now distributes about 85% of the products produced by Eko Dalmacija. The remaining 15% of products are sold to other large-scale distributors;
- **Finance facilitation support that has resulted in nearly USD 98,000 in debt financing and other financial inputs** to support the establishment of the cooperative and the expansion into the processing of high value added organic almond and olive oil;
- **Accounting training that has lead to the hiring of an accountant** to manage the cooperative's books. Hiring an accountant has helped to make the business activities of Eko-Dalmacija compliant with Croatian tax laws and has reduced the grey market activity of cooperative members.

Program Background and Results

FI has partnered with UNOPS to assist farmers in ECRA municipalities to develop organic farming. UNOPS has been combining grant funds and linkages with organic organizations to address a need in the area for organic products. FI assisted UNOPS and local farmers to form the Eko-Dalmacija Agricultural Cooperative in Kistanje. By establishing a cooperative structure that emphasizes organic production techniques and assisting farmers in ECRA municipalities to converting to organic farming, FI and its partners have helped small-scale local farmers to exploit a market niche for organic foods that is expanding continually, and is optimally suited for the conditions in the Dalmatian hinterland.

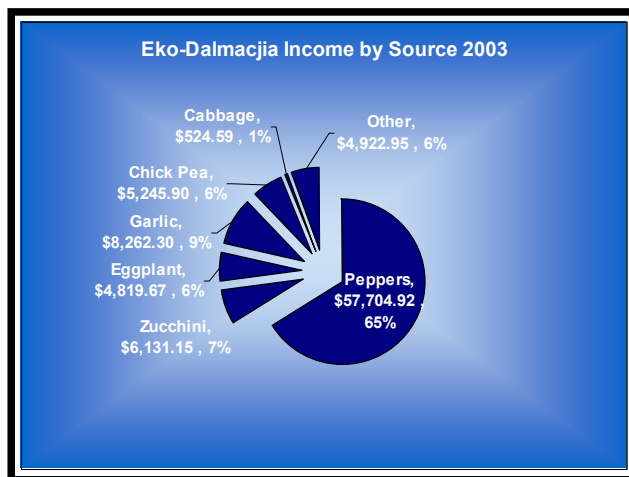
FI engaged Swiss Consultant Yann Chatelain, a professional with extensive experience in organic agricultural development to assist in the cooperative's development. Mr. Chatelain worked for three years at such an organization before beginning his consulting assignment in Croatia. Although the

problematic real estate records of those active in Eko-Dalmacija makes attaining Croatian organic certification nearly impossible, members have German Naturland organic certification due to FI program activities. Consultant Chatelain worked extensively with FI staff and local farmers to improve the farmers' organic production and the cooperative's operations.

Market linkages established in cooperation with FI have resulted in a significant increase in income for members. FI provided assistance to solidify a long-term sales relationship between Eko-Dalmacija and a large-scale food processor, SMS d.o.o. of Split. SMS purchases about 85% of organic agricultural produce grown by the cooperative at a premium price; the remaining 15% is sold to other distributors in the region. Moreover, SMS's satisfaction with product quality and the professionalism exhibited by Eko-Dalmacija management has resulted in open-ended contract agreements for many products that provide a guaranteed market for the entire volume that the cooperative is able to produce. FI has enabled the cooperative to gain additional product recognition in the wider Croatian market by supporting activities in the 2003 Croatian Ecological Fair in Cakovec. At this fair, the Cooperative won first prize in the "Best Product on the Market" category for its mixed salad product offering.

In order to add increased value to the cooperative's activities, FI has encouraged the cooperative to expand into value-added processing. FI has provided substantial investment facilitation assistance to help the Eko-Dalmacija Agricultural Cooperative expand and develop production capacity. FI prepared a business plan and conducted other finance facilitation activities that resulted in the cooperative securing financing for the construction of an organic almond and olive oil production facility. Through ASB, **USD 31,576** in EU funds were used for the reconstruction of a facility where olive oil production will take place. FI also facilitated **USD 65,000** in debt financing from the World Bank for equipment to equip the oil processing facilities. As of April 15th, the reconstruction has been completed and the cooperative is installing the production equipment. When production begins, 3 people will be employed full time in the production and processing of oil and at least 4 cooperative members will be employed in the production of raw materials for processing. The production facility will realize substantial gains in income for cooperative members through the sale of finished oil to SMS. It is anticipated that this premium will encourage other local farmers to join the cooperative and realize income gains from the production of raw materials.

Presently, the Eko-Dalmacija Agricultural Cooperative is serving to expand income and employment opportunities for the 27 members and 30 cooperants. The severe drought affecting Croatian agricultural producers in 2003 substantially reduced total productivity. Nevertheless, FI technical assistance resulted in substantial income for members in the cooperative's first year of production. Approximately 65% of Eko-Dalmacija's income during the first year of operations was a result of the production and sale of peppers, while the remainder represented the sales of other vegetable products such as garlic, zucchini and eggplant. Total sales were approximately **USD 87,611** in 2003, representing income of about **USD 1,537** per individual transacting through the cooperative.



Currently, the cooperative is in the process of opening a shop to make it easier for members to gain access to organic seed and other inputs, and securing inputs for the production of olive oil.

2.3 Dairy Processor and Cattle Farmer Partnership Development

Client(s): I-Pak Dairy, Zagora Agricultural Cooperative, local farmers

Municipalities Affected: Drnis and surrounding areas

Program Summary: FI delivered technical assistance, training and created market linkages that lead to the establishment and development of the Zagora Agricultural Cooperative of Drnis in 2003, which has provided a vehicle for 561 cattle farmers in Drnis and surrounding areas to earn significant income from milk sales and state subsidies by supplying milk to the I-Pak Dairy. The program also stabilized problematic milk supplies for I-Pak, enabling them to expand processing to approximately 5,000 liters of milk per day and 8 employees. Specific assistance delivered included:

Program Results Summary: Cooperative established in Q1 2003, number of individuals transacting in cooperative grows to 561, currently estimated liters of milk processed in 2004 by I-Pak increases approximately 150% from 2002 level, cattle productivity expands, **USD 65,000** in debt financing awarded for hard cheese production equipment.

Summary of Assistance Delivered by FI Under ECRA:

- Delivered technical assistance that resulted in the **establishment of the Zagora Agricultural Cooperative**. The cooperative provides an organizational structure for small-scale local dairy producers to protect small-scale farmers in the area;
- **Solidified market linkages to the I-Pak dairy** by developing an innovative leasing contract that has enabled members of the Zagora Cooperative to **earn over USD 250,000 per year** in milk subsidies from the Croatian Government to supplement approximately **USD 500,000 per year** in payments from the milk processor. The combined income streams have helped to stabilize I-Pak's supply of raw materials strengthened the Zagora cooperative and provided significant income gains to cooperative members. As a result of this assistance, local farmers have a greater incentive to invest in larger herds and become professional cattle breeders;
- **Delivered accounting training that has resulted in the hire of a full-time accountant** and has brought members benefiting from state subsidies into full compliance with Croatian financial reporting regulations;
- **Delivered finance facilitation support that has resulted in nearly USD 78,000** in debt financing and other financial inputs to support the growth of the cooperative. Of this, **USD 65,000** debt financing has enabled the cooperative to expand into high value-added processing with the construction of a sheep and goat cheese production facility, which will provide significant additional income for members;
- **Established market linkages to feed suppliers and provided bovine health training**, which has substantially lowered input costs for Zagora members and also greatly increased livestock productivity, enabling individual dairy farmers to increase their profit levels.

Program Background and Results:

I-Pak Dairy is a SME located in Pakovo Selo (Drnis municipality) that opened in 2001 to produce hard and soft cheeses for sale to bakeries throughout the region. The dairy produces high-quality quality fresh cheese that has earned I-Pak a strong reputation and client loyalty. Under the ECRA Program, FI delivered extensive technical assistance to simultaneously stabilize raw material sources for I-Pak and gain significant income for small scale local cattle farmers. The primary focus of this activity was to improve I-Pak's relationship with farmers by providing incentive structures to motivate the milk producers to increase the quality and quantity of milk sold to the dairy.

FI initially helped I-Pak to establish relationships with individual farmers and organize the collection of milk from the many small-scale producers in the most cost effective way possible. Producers were provided with income from the sale of milk to I-Pak and from supplemental state subsidies. The amount of income earned related to the quality of the milk brought by the producer to one of I-Pak's collection points. Previously, many of the farmers had provided milk to a large milk processor in Split; the processor was sometimes years delinquent in paying farmers. I-Pak quickly established a reputation for timely payment and honest business dealings with milk producers, which helped to develop a beneficially loyal working relationship between the farmers and I-Pak. By year-end 2002, I-Pak was the major purchaser of milk in the area, although the processing facilities only operated at about 15% capacity.



In 2003 a new agricultural law took effect in Croatia that eliminated subsidies for small farmers and threatened income security for many milk producers in the Drnis area, particularly those that supplied milk to I-Pak. Subsidies provided about 33% of the income farmers received from milk production. Without them, the attractiveness of selling milk and the incentive to invest in additional cows to expand production was severely limited.

FI staff examined the new law and worked with I-Pak to develop an innovative contract arrangement that increased opportunities for small-scale farmers to earn subsidy income through milk sales. FI helped to organize producers to form the Zagora Agricultural Cooperative. Farmers signed leasing agreements with the cooperative, which allowed the cooperative to claim member's cows for the purpose of obtaining the state subsidy. I-Pak purchased milk from Zagora and both subsidy payments and milk sales revenue was paid out to members through the cooperative. The contract had the benefit of stabilizing farmer income per liter of milk, thereby returning a positive incentive to farmers that produce milk.

The incentive structure has provided an impetus for farmers to invest in expanded cattle herds and milk production. To accelerate the growth of milk production volumes in the Drnis area, FI has facilitated the delivery of a substantial number humanitarian cattle donations and micro loans through Croatian savings and loan providers to residents that are actively engaged in the sale of milk through the cooperative. During the lifespan of the ECRA program, the number of cattle in the Drnis area has increased tenfold from under 200 cattle in the year 2000 to over 2,200 at the submission of this report.¹ These investments in expanded livestock herds were warranted by the fact that I-Pak had the capacity to process additional quantities of milk.

As an additional boost to farmers transacting through Zagora, FI conducted training seminars on bovine nutrition and milking best practice. Seminars were provided by FI staff and consultants in cooperation with the Croatian Livestock Center. The seminars introduced farmers to high quality feeding methods, proper milking techniques, and other appropriate methods for increasing quality and productivity from the cows. Increased productivity directly translates into increased income for the farmers due to additional sales to I-Pak. Milk quality, however, is also an important determinant of the income received by farmers. Table 1 illustrates approximate values paid to farmers by I-Pak Dairy and Zagora for the sale of milk to I-Pak. I-Pak pays farmers about 33% more for each liter of high quality milk, and the subsidy that farmers obtain through Zagora is about double the value of low-quality milk.

¹ Source: Croatian Livestock Center – Sibenik County

TABLE 1: Per Liter Milk Income Paid to Farmers by Type and Quality

	Highest Quality	Lower Quality	Quality Premium
Milk Income from sale to I-Pak	\$0.33	\$0.25	33%
Subsidy Income through Cooperative	\$0.16	\$0.08	100%
Total	\$ 0.49	\$0.33	50%

Source: I-Pak Dairy

To appreciate the impact of the seminars on an individual farmer, a useful example is the case of Miroslav Pletkovic, a dairy farmer living in Drnis. As a Serb returnee, Miroslav is an interesting case of success for FI assistance under the ECRA program. At the beginning of the program, Miroslav had barn space, but no cattle. FI assistance helped him to start a herd with grant donations; loans and other financial inputs helped him to grow the herd to over 30 cows. Perhaps most important for the success of this budding cattle rancher is that Miroslav has been eager to listen to and try new techniques. Prior to the training seminars, Miroslav's average cow produced approximately 15 liters of milk per day. With low quality level milk, the cow earned Miroslav approximately $15 \times \text{USD } 0.33 = \text{USD } 4.95$ per day. The seminars, along with other trainings have helped Miroslav to raise productivity of the average cow to about 27 liters of high quality milk per day. The result is $27 \times \text{USD } 0.49 = \text{USD } 13.23$ per day, or USD 8.28 higher per cow, per day. On an annual basis, this represents approximately USD 2,900 in additional income for Miroslav, for each cow. Miroslav is arguably the farmer that has been the most successful in adopting new techniques under the program; his success has earned him increased income and has provided an example for others to follow.

On an aggregate basis, the results for Zagora members have been remarkable as shown in the tables below). The proportion of high quality milk production has more than tripled. At the beginning of 2003, less than 22 percent of milk processed by I-Pak was of the highest quality level. As of the close of ECRA program, nearly three quarters of milk processed was considered high quality. Much of the milk processed by the Zagora/I-Pak relationship comes from small family farmers with a single cow. Although these farmers often retain some of their cow's daily production of milk, the productivity and quality improvements contribute significant income at the household level.

Table 2: Proportion of Production by Quality Level

	Highest Quality	Lower Quality
Jan-2003	22%	78%
Apr-2004	74%	26%

In 2003, FI partnered with the Demos savings and loan cooperative to help expand the institution's activities by opening up an office in the Drnis municipality. FI assisted Demos in understanding the local economic situation and the importance of client cooperation with Zagora and I-Pak as established markets for the milk produced by cattle that has been purchased with Demos loan funds. Focusing on the market linkage helps Demos to reduce default risk on loans because the farmers have a pre-established purchaser for the milk.

The FI assistance program has provided tremendous gains for I-Pak, Zagora and the 561 families that sell milk through the cooperative to the dairy. I-Pak has expanded production markedly as a result of this program. At year-end 2002, I-Pak processed approximately 2,000 liters of milk per day and had 5 employees. By year-end 2003, I-Pak had hired an additional 2 employees and doubled its daily processing volume. By April 2004, I-Pak expanded processing to 5,000 liters per day and has 8 employees. FI support resulted in a boost in capacity utilization for I-Pak from about 15% to over 40% about one year. Based on the current growth in production, Zagora expects that payments to farmers from milk sales and subsidies in 2004 will be between **USD 878,000** and **USD 998,000**, an amount of approximately **USD 1,566.56 per family transacting through the cooperative**. For many families with a single cow, this is a much needed supplement to income received from pensions or a principle occupation. Yet, 47 families (29 living in ECRA municipalities) have monthly incomes in excess of **USD 1,000** per month.



Zagora and I-Pak plan to continue to work together for their mutual benefit. To increase income opportunities for Zagora members, FI prepared a business plan and facilitated **USD 65,000** in World Bank debt financing for the construction of a sheep and goat hard cheese facility, which is currently completing construction. The premium for goat and sheep milk in Croatia ensures that many residents living in the ECRA municipalities of Drnis and Kistanje will realize income from the provision of sheep and goat milk to Zagora and cooperative members will receive a dividend from the sale of the cheese. Due to the excessive regulations on cheese production in Croatia, the facility will be located on the premises of I-Pak, which already satisfies regulations and is positioned to assist the cooperative with distribution of the cheese.

2.4 Enhancing the Impact of Major Foreign Investment on Local Economy

Client(s): Elan JSC and Residents of Obrovac Community

Municipalities Affected: Obrovac

Program Summary: Developed a targeted employee training program that accelerated employment growth and increased the local economic development impact of major FDI investor Elan JSC in Obrovac. The training program made it possible for Elan to hire 30 Obrovac residents to work in a new production facility, instead of hiring already-qualified residents of Split and Zadar. The program also reduced training costs for Elan, enabling the facility to expand hiring at a much faster rate than otherwise would have been achieved.

Program Results Summary: 30 local residents receive certification and employed by Elan, accelerating the production growth of the facility.

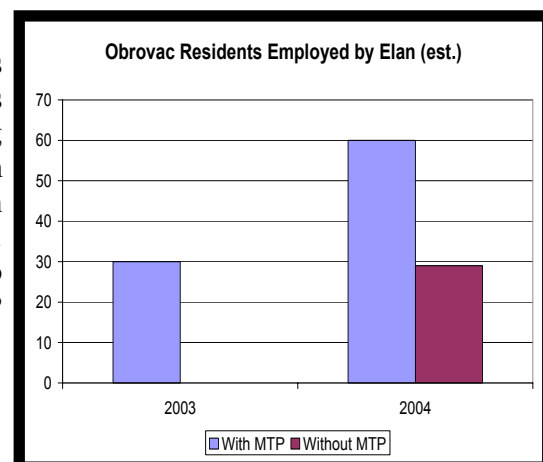
Program Background and Results

Elan JSC purchased and refurbished a production facility in Obrovac and planned to employ local employees in the construction of small yachts. The process of acquiring the facility from the Croatian government was so time consuming and costly, that when refurbishments were eventually completed, Elan was well behind schedule and over budget.

To begin production, Elan needed to hire 30 employees to work in the plastics department. Originally, the firm had planned to hire local Obrovac residents and train them in plastics molding, but the acquisition delays had already drained budgetary resources reserved to fund such a training program. As a consequence, Elan had planned to hire employees primarily from the Split and Zadar areas. These employees would be considerably more expensive for Elan and would add little value to the local Obrovac economy.

FI worked with Elan's management team in Obrovac to identify the needs of both Elan and local residents that were candidates for employment. FI technical assistance focused on the development and execution of a master training program (MTP) to certify local residents for employment at the Elan production facility. Elan's original desire was to administer much of the training in Slovenia. However, the equivalent training, if given in Slovenia, would not be entered into employment records of Croatian citizens. The MTP that FI developed provided training exclusively in Croatia so that the local residents received certification in their employment records, which will enable them to be more qualified for, and more competitive in, the Croatian job market. As a contribution to the program, Elan provided salaries and full benefits to the attendees during this training. The development and delivery of the MTP made it unnecessary for Elan to hire the already-certified residents of Zadar and Split, and has significantly contributed to an increase in employment levels in the area.

As a result of this FI training program, Elan has provided sustainable employment to 30 local residents at its production facility in Obrovac. By reducing overall production costs for Elan, the training program has provided a substantial lift to employment in Obrovac. FI estimates that the reduced costs (i.e. improved productivity) for Elan enabled the facility to hire an additional 7 Obrovac residents since the MTP was delivered.



2.5 Livestock Credit Program: Facilitating Transformation to Commercial Farming

Client(s): Agro Natur Agricultural Cooperative, Bagen Agricultural Cooperative, Spancic Agricultural Cooperative

Municipalities Affected: Obrovac, Kistanje, Drnis, Dvor, Pakrac, Hrvatska Kostajnica,

Program Summary: FI designed and implemented an innovative Livestock Credit Program (LCP) that paired investments in the revitalization of livestock herds with market linkages to meat processors to contribute to income growth and employment.

Program Results Summary: Increased access to markets and finance for agricultural producers.

FI designed and implemented an innovative **Livestock Credit Program (LCP)** that paired investments in the revitalization of livestock herds with market linkages to meat processors to contribute to income growth and employment for residents of Dvor, Pakrac, Hrvatska Kostajnica, Obrovac, Kistanje, and Drnis. The program was introduced in Budget Modification 02 and expanded in Budget Modification 04. In-kind LCP animal loans assisted over 70 beneficiaries to receive 2,325 animals, enabling these farmers to increase their herds to the levels required for commercial livestock breeding. Pigs were loaned to breeders in Drnis, Dvor, Pakrac and Hrvatska Kostajnica, while sheep and goats were loaned to breeders in Drnis, Obrovac and Kistanje.

3.5.1 Sheep and Goat LCP

Initially, FI intended to loan milk cattle to farmers, but an import ban on cows made it impossible to obtain sufficient quantities of quality cattle at a reasonable price. This resulted in a shift from an emphasis on milk production to a focus on establishing market linkages for the sale of lamb and kid meat. Beneficiaries signed forward sales contracts that provided a basis for a long term sales



relationship for the purveying of fully-grown animals. Beneficiaries were contracted to sell animals to the Zadar lamb meat processor Olvin LLC, which paid beneficiaries on time and in cash for the purchases. Some animals were sold on local livestock markets, where slightly higher prices exist during the tourist season. The program showed success and FI believes that the market linkages established will be sustainable and will continue in subsequent years. This optimism is evidenced by the fact that a resident of the Obrovac municipality was hired by Olvin to collect and transport lambs from Obrovac to Zadar in future years.

As of the close of the ECRA Program, payments were received from the majority of LCP beneficiaries. The success of the market linkage and repayment record for the sheep and goat program is remarkable when viewed in light of the climatic anomalies that existed through late 2002 and early 2003. The winter months were extremely severe and many agricultural producers throughout the region suffered severe losses of livestock due to disease. Compounding the difficulties faced by these breeders during the winter was a low reproductive rate and slow animal mass accumulation of young lambs. These unusually unfavorable breeding results were directly attributable to the severe drought that devastated Croatian agricultural production in 2003. The water shortage was declared “the worst drought in Croatia’s history,”² by international climate experts. Final agricultural loss estimates from the drought are still being calculated, but a Ministry of Agriculture assessment in mid-May 2003 estimated that USD 217 million in losses had already been

² *Earthweek: A Diary of the Planet*, by Steve Newman, 5-16-2003: Earth Environmental Service.

inflicted on Croatian farmers at that time.³ As a result, the government declared a natural disaster for agricultural producers, which allowed most farmers to defer loan payments to banks. The LCP was not affected by the state of emergency and as a result FI attempted to achieve full repayment from all clients as per the arrangement specified with Mercy Corps in Budget Mod 02. FI's training, technical assistance and veterinary programs helped to mitigate the impact of the severe climate conditions substantially, but breeders were still hard hit.

Climate conditions negatively impacted breeding and animal growth results, thereby severely mitigating the income gains realized by the breeders. TABLE 3 and TABLE 4 compare the income and flock size growth rates for LCP beneficiaries. The computations assume that the breeder uses all profit to purchase new sheep. Drought conditions decreased the reproduction rate from 1.3 to 1.1, and increased the cost of raising the animals by about 25%, slightly reducing the anticipated income of the farmers.

TABLE 3: Estimated Income and Revenue for Typical LCP Recipient Based on Actual Results

	2003	2004	2005
LCP Sheep (+ new purchases):	45	67	121
Repr.rate	1.1	1.3	1.3
Sale price/kg:	3.75	3.75	3.75
Sale wt:	25.00	25.00	25.00
Subsidy/sheep:	30.00	30.00	30.00
Sheep Purchase Price	121.00	121.00	121.00
Principle outstanding:	5,445.00	3630.00	1815.00
Total revenue:	\$5,990.63	\$10,175.63	\$18,376.88
Total subsidies:	\$1,350.00	\$2,010.00	\$3,630.00
Sales revenue:	\$4,640.63	\$8,165.63	\$14,746.88
Production costs:	\$1,350.00	\$1,608.00	\$2,904.00
Repayment Installment:	\$2,037.03	\$2,037.03	\$2,037.03
Profit:	\$2,603.60	\$6,530.60	\$13,435.85

TABLE 4: Income and Revenue for Typical LCP Recipient Based on Expected Results

	2003	2004	2005
LCP Sheep (+ new purchases):	45	76	139
Repr.rate	1.3	1.3	1.3
Sale price/kg:	3.75	3.75	3.75
Sale wt:	25.00	25.00	25.00
Subsidy/sheep:	30.00	30.00	30.00
Sheep Purchase Price	121.00	121.00	121.00
Principle outstanding:	5,445.00	3,630.00	1,815.00
Total revenue:	\$6,834.38	\$11,542.50	\$21,110.63
Total subsidies:	\$1,350.00	\$2,280.00	\$4,170.00
Sales revenue:	\$5,484.38	\$9,262.50	\$16,940.63
Production costs:	\$1,080.00	\$1,824.00	\$3,336.00
Repayment Installment:	\$2,037.03	\$2,037.03	\$2,037.03
Profit:	\$3,717.35	\$7,681.47	\$15,737.60

³ *Terra Daily: Your Portal to the Earth*, "Drought Devastates Crops in Croatia," May 16, 2003.

3.5.2 Swine LCP



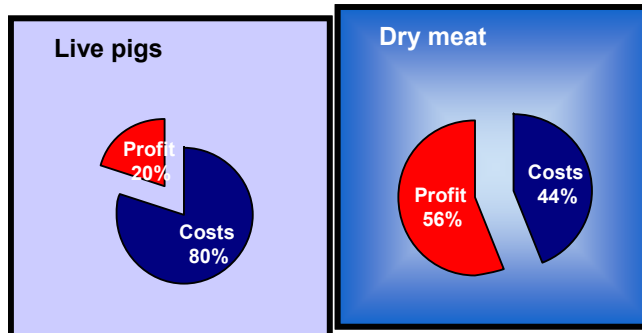
In accordance with Budget Modification 02, FI expanded the LCP program into pig loans. FI disbursed 1,000 pigs to 33 agricultural producers in Drnis, Dvor, Pakrac and Hrvatska Kostajnica (providing loans to the breeders of varying size). Loans carried an 8% interest rate and had a grace period on principle payments until the time of pig slaughter. As part of the loan agreement, farmers signed forward contracts with Drnis pršut producers for the sale of raw pršut. The program was implemented in partnership with two Agricultural Cooperatives (Baden and Agro Natur) and the Croatian Ministry of Agriculture, which provided certification services to register the meat as high-quality and domestic production.

FI developed this innovative program to form contractual market linkages between pig producers in the Banovina area and pršut processors in Drnis, through the provision of technical assistance and marketing services. The goal was to facilitate the regular purchase by the Drnis Prsut Association of quality domestic pork, while enabling agriculture producers in Banovina to earn income by offering such products through sustainable agricultural cooperatives. Securing a source of high quality pigs was essential for the Drnis Prsut Association to attain a geographical origin trademark for its products. Acquiring geographical protection necessitated that only high quality domestic ingredients are used in the production process.

In accordance with the specifications for premium pršut, FI required the breeders to hold the LCP animals longer than they normally would have in order to grow the pigs to an additional 40% weight requested by the Drnis Prsut Association. The extra growth time requested by the Association resulted in higher costs for feeding the pigs, but the premium negotiated in advance with the Association was more than sufficient to cover these expenses and return a healthy profit.

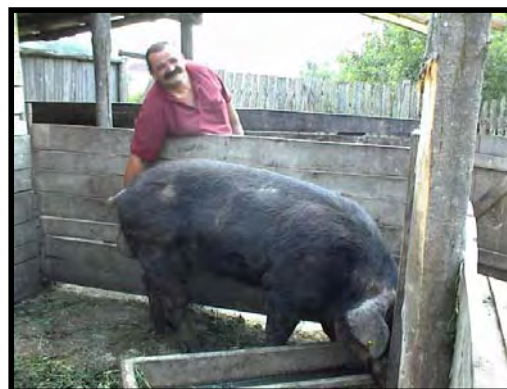


Live pigs that the breeders had previously sold earned about **USD 240** per pig, of which less than **USD 50** was profit. Swine dry meat for prosciutto production has a total value of about **USD 480** per pig. This meant that even if the farmers paid a slaughterhouse **USD 20** to prepare the pig, their profit would be about **USD 270** per pig after expenses. Even factoring in the additional feed costs required to grow pigs to the size demanded by premium processors, the breeders would realize over four times the profit of selling live pigs the traditional way.



The agricultural producers who received high-quality pigs through their respective cooperatives in Dvor, Pakrac and H. Kostajnica reported their satisfaction with the program and made loan repayments as scheduled. The Drnis pršut processors visited these farms on a number of occasions to view the production techniques and solidify the market linkage.

Despite the forward contract arrangement that guaranteed farmers a generous premium on the raw pršut sold to the Drnis Association, several of the farmers attempted to reap additional profits by ignoring the feeding program stipulated in the loan contract. Although the contract-mandated feed prices rose appreciably as a result of the 2003 drought, breeders did not inform FI of their situation and, in FI monitoring visits, these farmers persistently hid the fact that they were using lower-quality feed. FI only discovered the problem when the pigs were slaughtered and the slaughterhouse complained that the fatter than expected pigs did not justify the substantial premium FI had negotiated for the meat. The slaughterhouse had been contracted as an intermediary to shape the raw prsut for the Prsut Association and sell the remaining pig parts through its own distribution network, but ultimately refused to work with a few individual farmers.



This unfortunate result has actually proved to be beneficial to the cooperative in the long run. The breeders that used cheap feed were disappointed to compare the income that was agreed upon with the slaughterhouse and the income they actually received as a result of the sale of their lower quality pig. This has provided a powerful lesson to these breeders and also serves as an example to other



breeders who have expressed interest in building upon this pilot project in subsequent years. It has been extremely frustrating for these few farmers to compare their income with their colleagues that followed the feeding program and realized almost **USD 5,000** in profit.

DEMOS SLC is currently in negotiation with Prsut Producers and pig breeders to evaluate how this very promising program can be continued and expanded in future years in order to provide additional income opportunities for a wider group of breeders and also help Prsut Association members to improve access to high quality raw materials.

3. Results Achieved During Program Implementation

3.1 Program Results:

See attached "ECRA Indicators Table" and accompanying notes in Appendix B.

3.2 Program Results and Impact Assessment

As contractually negotiated with Mercy Corps, FI was provided with a grant to create at least 215 jobs; complete two Economic Development Plans; assist 75 clients to conclude contracts related to the development of linkages with suppliers, processors or sources of grant/debt financing; and 30 business entities will have accessed loans/financial inputs and/or conclude contractual producer/buyer partnerships.

FI significantly exceeded the performance indicators outlined in FI's agreement with Mercy Corps with respect to the creation of jobs, the signing of forward contracts, and the realization of financial inputs for investment. Economic development plans were created and submitted to the municipalities of Drnis, Donji Lapac, Kistanje and Obrovac. The results achieved have greatly improved the quality of life for the direct beneficiaries of FI technical assistance, their families and the ECRA communities themselves. The table below summarizes the achievements made by FI during the implementation period October 1, 2001 to April 15, 2004.

The business environment in ECRA municipalities is in need of additional measures to accelerate the transition to a market based economy with businesses that can operate effectively in a more competitive EU marketplace. Nevertheless, outstanding progress has been made both in terms of the advances made by individual clients and the progress achieved for other community members through the general improvement of economic activity. The examples of best practice that have been provided by FI's technical assistance are a legacy to the greater community and will continue to encourage change as other groups strive to rival the success of FI's clients.

The results of FI activities are summarized in the below table. As shown, **246 jobs** were directly created in ECRA municipalities during the implementation of the program. This figure represents a substantial gain in employment for communities with such small populations and limited access to markets and financial capital. The gain is **14%** higher than the performance target for this indicator. In addition, FI estimates that 20 additional employment positions were positively affected by FI assistance either through the process of indirect job creation, the securing of jobs that would otherwise be lost in the near future, or the direct creation of jobs in non-ECRA municipalities through support to cooperatives that have memberships that extend beyond ECRA borders.

Operating according to the methodology outlined in Section 2, FI assistance under the ECRA program resulted in **78** sales contracts. These contracts had a total value of **USD 776,627**, which is **37%** above the targeted level of performance. The market linkages were typically matched with investment facilitation. FI investment facilitation that provided business plans, negotiations with banks and other assistance securing financial inputs in the capital scarce ECRA municipalities resulted in **78** investment inputs valued at over **USD 893,229**. This is **319%** above the targeted level of performance. The collaboration of local communities and other organizations in FI activities is evidenced by the \$1.06 million in cost share generated by FI activities. This is over 109% higher than the cost share amount required under the ECRA program.

TABLE 4: FI Program Performance Measured Against Targeted Performance Levels

Performance Indicator	Performance Target	Actual Achieved by End of Project	Target Achieved	Target vs. Actual
(1) Number of individuals <i>employed</i> in ECRA assisted individual enterprises	215 individuals employed	246 individuals employed	Target Exceeded	+14%
IR 3.1.2.1 INDICATORS:				Target (\$) vs Actual (\$)
(1) Value of sales contracts concluded by ECRA assisted producers, firms, producer associations and cooperatives.	75 contracts concluded; Total value: \$567,000	78 sales contracts concluded; Total value: \$776,627	Target Exceeded	+37%
(2) Number, source, and value of loans/ financial inputs received by business clients/enterprises since ECRA.	30 inputs; Total value: \$213,000	78 inputs; Total value: \$893,229	Target Exceeded	+319%
Cost Share and Community Contribution	\$508,059 to be achieved	\$1.064 million achieved	Target Exceeded	+109%

Below, additional results related to the results achieved by FI's assistance are outlined.

Performance Indicator 1: 215 ECRA-municipality residents employed in ECRA-assisted enterprises

FI's program achieved substantial gains in employment for individuals residing in ECRA municipalities. *FI's activities resulted in the creation of 246 jobs during the life of the program, 14 percent* higher than the indicator target.

The job creation figure reported above a very conservative estimate of the employment generation impact achieved by FI assistance. Employment results have been on the basis of employment or debt financing contracts or an established sales relationship through a cooperative purchase agreement that has been directly awarded as a result of FI assistance delivered to client businesses.

In preparation of this final report, FI's follow-up assessment attempted to estimate the employment impact of assistance measures in order to provide a wider perspective on the employment-creation impact of FI's ECRA activities on the Croatian economy. FI estimates that in addition to the 246 jobs reported, approximately 221 additional jobs have been indirectly created, secured, or created outside of ECRA municipalities.⁴ These additional jobs are employment positions that would not have otherwise been created or were created in non-ECRA municipalities through direct support to ECRA agricultural cooperative clients that have memberships that transcend municipality boundaries.

⁴ Note that this information is provided for illustrative purposes only, to attempt to evaluate the true impact of the assistance provided under the ECRA program. We have not reported these numbers in the indicator totals, nor have we done more that outline the basics of the methodology used.

The basis of this **shadow estimate** of job creation is as follows:

- The indicator total reported does not reflect the ***indirect creation of jobs*** - new positions created by non-client businesses that have added jobs to meet increased demand as a result of the income and employment generation activities that have directly benefited FI clients. FI estimates indirect employment generation resulting from assistance delivered in ECRA municipalities at 20 jobs. [using methodology outlined below]
- The indicator total does not reflect ***FI's efforts to secure jobs that would have otherwise been lost or that have been converted from temporary to permanent employment***. For example, without FI's competitiveness enhancement support, the SMEs that are members of the Drnis Prsut Association would likely be on the brink of extinction within two production cycles. The total reported does not reflect any of the jobs that were preserved for the owners of these SMEs or their existing employees. FI estimates the number of jobs preserved to be approximately 46.⁵
- FI's job creation indicator total ***does not take account of jobs that have been created by several employers***, after the FI's initial assistance has been delivered, ***due to an acceleration of the growth rate of the enterprise***. We estimate the number of jobs created that would not otherwise exist at approximately 7 positions.
- The figures do not account for the ***substantial increase in employment achieved in economically depressed areas outside of ECRA municipalities***. Several agricultural cooperatives founded in cooperation with FI under the ECRA program have a substantial membership that resides outside of ECRA municipalities. In particular, the Zagora Cooperative in Drnis and the Eko-Dalmacija Cooperative of Kistanje are among a larger number of producer groups that provide a regular source of income for non-ECRA municipality members that transact through the cooperatives. FI's activities to provide income opportunities for cooperatives have generated over 148 jobs outside of ECRA municipalities, in accordance with Mercy Corps monitoring and evaluation criteria.⁶
- FI's ECRA activities have include the operation of local Business Development Centers (BDCs) that have served as a point of contact in local communities and ***a distribution point for the large database of business development information that FI has assembled for the benefit of SMEs and entrepreneurs*** in the ECRA region. Many businesses and individuals were able to quickly and efficiently receive vital business information from these centers and did not seek additional services from FI staff. Based on the strongly positive feedback received by regular clients regarding the usefulness of these information services, it is believed that a significant fraction of the entities benefiting from this data have resulted in additional employment opportunities that are not reflected in the performance indicator total.

These estimates have been provided for illustrative purposes only, but do present a broader picture of the employment impact of FI technical assistance. Despite limited economic opportunities, the FI assistance program has provided significant economic gains to individuals and families residing in ECRA municipalities.

⁵ This total reflects jobs saved by the establishment of the Drnis Prsut Association and the competitive enhancement activities that will enable the SMEs that are members of the association to survive and grow as EU competition intensifies over the next several years.

⁶ This total reflects the 48 members, cooperants and employees of Eko-Dalmacija that reside outside of ECRA municipalities, and the 198 individuals transacting through Zagora that reside outside of ECRA municipalities. Both of these groups regularly conduct sales through the cooperatives. We estimate that about 40% of the Eko-Dalmacija individuals and about 65% of the Zagora individuals would not have supply contracts without FI assistance.

TABLE 5: Employment Impact of FI Assistance (Reported and Estimated)

	Total jobs created	USD spent on program activities per job created
Jobs directly created by FI's ECRA activities	246	\$7,624.26
Additional jobs created or preserved according to the criteria established above	221	N/A
Total Employment Impact:	467	\$4,016.21

To provide a *crude* estimate of indirect job creation, we construct a simple elasticity estimate for use as an employment multiplier. Using the standard equation for the elasticity of one economic variable to another, we construct the elasticity of employment with respect to income, which measures the percentage change in employment that accompanies a percentage change in income:

$$(\text{Arc}) \text{ Elasticity } \varepsilon(e, y) = \frac{\Delta \text{ employment} / \text{employment}}{\Delta \text{ income} / \text{income}}$$

As a rate of change (Δ), the equation requires two measurements (i.e. years). Assuming that the employment-income relationship in ECRA municipalities mirrors the aggregate performance of the Croatian economy, we can compute the elasticity of employment (e) with respect to income (y) using aggregate data that is available for 2001 and 2002 obtained from the web. This provides us with a measure of the relationship between income and employment changes during the 2001-2002 year. Due to the limited availability of economic data, we assume that the elasticity remains constant over time.

GDP was used as a proxy for income, but it is difficult to find employment data for consecutive years. As such, employment was estimated as:

Employment = population*workforce participation rate*(1-unemployment rate). This estimate is roughly consistent with the economist's standard definition of employment. Using macroeconomic data found on the web (primarily "Croatia at a Glance" from the World Bank), we estimate $\varepsilon(e, y)$ as an approximately .035% change in employment for a 1% change in income. The pattern of data that we are able to observe suggests this estimate is conservative. We estimate the percent change in total income generated in ECRA municipalities as:

$$\% \Delta Y_{\text{ECRA}} = \frac{Y_e + Y_m + Y_I}{Y_{\text{ECRA}}}$$

Where: Y_e is the income generated from new employment, Y_m is the income generated from the signing of sales contracts and Y_I is the income resulting from new investments (financial inputs). The total annual income generated in ECRA municipalities from new employment is estimated as: $Y_e = \text{EUR } 600 * 246 \text{ jobs created} * 12 \text{ months} = \$720 * 246 \text{ jobs} * 12 \text{ months} = \$2,125,440$, where EUR 600 is the estimated average income level of the new employment positions created. Estimates of Y_m and Y_I are provided directly from other reported indicators of \$776,627 and \$893,229, respectively. (Note that Y_I is a conservative estimate of the income impact of investment because \$1 of investment spending tends to generate more than \$1 of income). Y_{ECRA} is the estimated total annual income of the 7 ECRA municipalities in which FI operates, which is derived as the

$(.6) * (\text{aggregate Croatian GDP}) * (\text{fraction of the population in the 7 FI ECRA municipalities}) = (.6) * (\text{USD 19.5 billion}) * (.007) = \text{USD 83 million}$. The factor (.6) estimates that ECRA municipality GDP is about 40% less than the Croatian average.

The methodology suggests that GDP in ECRA municipalities increased about 4.5% as a result of FI technical assistance. The elasticity suggests that this results in a 0.16% increase in employment (indirect employment) in ECRA municipalities. ECRA employment before FI assistance is estimated as: $(\text{the fraction of the population in ECRA municipalities}) * (\text{total Croatian employment})$.

- (1) The total number of jobs in ECRA municipalities before FI assistance is: 12,476
- (2) The total number of jobs directly created: 246
- (3) The total number of jobs indirectly created $[100.16 * (2) * (1) - (2) - (1)]$: 20**

Note that this estimate is both conservative (we are likely underestimating the level of income created by FI assistance, leading to a similar underestimation of indirect employment) and crude (it assumes a very simple, static relationship between employment and income and does not account for the endogenous problem inherent to the construction of the elasticity). A more rigorous examination could be undertaken, but would require a considerable resource commitment that is not covered under the ECRA program.

Performance Indicator 2: 75 sales contracts concluded by ECRA assisted producers, firms, producer associations and cooperatives at a minimum total value of **USD 567,000**.

FI market linkages have resulted in the signing of 78 sales contracts for a total value of USD 766,627, 37 % above the targeted level of performance. FI has consistently linked every form of technical assistance to a clear income opportunity for its clients and has therefore insisted that all support be paired with the facilitation of trade linkages. Often, the development of long term producer-purchaser relationships has helped to solidify connections that will contribute to the long-run sustainability of the projects. Guaranteed sales terms provide producers with an incentive to expand production because the transaction parameters are known in advance and are less subject to unpredictable market conditions during the production cycle. By providing a forward contract framework for doing business, FI has helped to introduce a mechanism that leads to a stabilization of local markets, thus making new investment and the hiring of additional labor more attractive.

FI believes that these forward trade contracts produce significant positive externalities for the economy. By extending the effective duration of a producer-purchaser relationship, forward contracts decrease overall transaction costs by decreasing the amount of time and constant attention required by both parties in order to conduct business. These positive effects lead to not only an increase in profit margins for businesses, but also a decrease in prices for local consumers.

Performance Indicator 3: 30 loans/financial inputs received by ECRA business clients/enterprises at a minimum **total value of USD 213,000**

FI investment facilitation activities have resulted in clients receiving 78 loans and financial inputs for a total value of USD 893,229, a total of 319 percent above the targeted level of performance. Investment promotion has been a key focus of FI activity under the ECRA program. Many agricultural producers and SMEs located in ECRA municipalities lack sufficient scale of production to meet the needs of processors or distributors of finished products. This makes them less cost

competitive, less attractive as a source of finished products and often limits their market access beyond the ECRA region.

FI has aimed to promote an investment strategy for ECRA clients consistent with the client's goals and level of development. Financial inputs have included state subsidies and grants awarded by non-US donors, but the overwhelming emphasis has been on securing more sustainable debt financing. Although various legal issues make the negotiation of debt financing arrangements extremely difficult in the war-affected areas, FI's finance facilitation support has resulted in a significant number of debt financing inputs in ECRA municipalities.

We note that the total reported herein does not include 14 loans totaling **USD 203,290** loan from Postanska Banka that will be awarded to the Lika Cooperative members of Donji Lapac after the ECRA program ends (after the bank has completed the processing of submitted documents, expected in late Spring/Early Summer 2004). When awarded, this loan will close a long struggle by Lika Cooperative members who have had difficulty securing the loan without land records, which were destroyed during the war. Without FI assistance during the process, the cooperative would have had little chance of receiving the loan. In a later section, we will describe some impediments to debt financing facing clients such as the Lika members in rural areas of Croatia.

3.3 Other Positive Changes

Employment and income generation activities increased the stability of rural communities and the encouraged the development of the local democratic process. Stabilizing local income levels and expanding economic opportunities tends to decrease migration and positively impact the integration of war-affected communities. FI has been an active participant in local community groups and has had close relationships with local governance structures. The achievements made by FI's economic assistance initiatives in collaboration with these civic and municipal structures has helped to underpin the local democratic process by legitimizing the perception that these authorities are able to bring positive changes for the benefit of their constituents in the local community. In fact, FI's achievements were perhaps augmented by a closer relationship with local leadership groups; a positive correlation appears to exist between FI-municipality interaction and general economic progress as evidenced by the close relationship and significant results achieved in Drnis, where FI's main office has been located and where FI assisted the Drnis Prsut Association and the Zagora Agricultural Cooperative.

3.4. Program Sustainability

With any development-oriented program, the matter of sustainability inevitably arises in the course of evaluating programmatic impact. In the case of the FI assistance program under ECRA, the organization has placed particular emphasis on two different forms of sustainability. *Project sustainability* refers to the potential for the Zagora Cooperative, I-Pak Dairy, Drnis Prsut Association and other entities that FI has helped to form, to continue to grow after the life of the ECRA Program. *Service Sustainability* refers to the potential for a continuation of the services provided by FI after the close of the ECRA Program.

The majority of FI assistance projects conducted under ECRA are sustainable, and the services clients will continue to operate and thrive after the end of the program. The key ingredient to ensuring



project sustainability is the creation of an incentive system that gives individuals a lasting opportunity to earn income through the mechanisms established in cooperation with FI. The Zagora Cooperative, for example, provides a significant income source for its current members. The high visibility of this income to the community as a whole provides an incentive for additional people to invest in cattle herds, become members of the cooperative, and gain income and employment. SME assistance has generally enabled clients to become more cost competitive, exploit niche products or invest in expanded production. This assistance has generally accelerated growth considerably for the business and provided a basis for continued expansion. An excellent example is provided by the Vojvodic Sawmill. FI finance facilitation resulted in EU grant funding for the reconstruction of the facility. The increased capacity and year-round capability the sawmill has gained, has enabled the business to add about one additional employee every other month, and all indications are that the sawmill will continue to expand until it reaches full capacity and requires additional investments.

To evaluate *organizational sustainability*, during the final months of the ECRA Program, FLAG International conducted a market feasibility study to determine if there existed a possibility for a follow-on organization to deliver firm-level technical assistance services on a continual basis. Through many incarnations, FI has been active in the process of economic development in Croatia and FI is strongly interested in continuing its high-impact work in the Croatia. FI feels an obligation to continue serving the needs of its traditional client base in the war-affected areas, while at the same time; FI is dedicated to building on its own experience and local knowledge.

Without donor funding, any such activity must be fee-based, with a structure that is sufficient to cover all local operating expenses. To evaluate the demand for such services, FI: mailed marketing surveys to a simple random sample of nearly 250 SMEs operating in the Sibensko-Knin, Zadar and Lika counties; conducted interviews with selected firms; and experimented on a limited basis with charging (at-cost) fees for business plans and finance facilitation. Unfortunately, program resources and ECRA project commitments did not permit a more comprehensive analysis. The results largely indicated respondents' interest in education and training services, but more limited potential for fee-based technical consulting, business planning and finance facilitation. The market for these services appears to be more limited because individuals are unwilling or unable to pay sufficiently to cover operational costs. Our analysis suggests that low demand among potential clients that do have the ability to pay, largely stems from hubris (an unwillingness to demonstrate the weakness of needing outside consulting), an expectation that humanitarian/development programs will continue to provide the services for free, and/or a fear that payment for such services will not be justified by subsequent results. On the supply side, one must realize that the low population density of rural Croatia means that identifying business opportunities is often costly in terms of transportation and human resources.

As the ECRA Program closes, FI's local non-profit affiliate, Delaware International, will remain active in the delivery of assistance in Croatia's economically depressed areas. Based on the results of the sustainability analysis, donor-assisted projects will continue to form the basis of DI's activities in the immediate future. Yet, the organization will serve as a valuable resource to other local businesses that do not qualify for donor assistance. By continuing to motivate economic development activities in the region, DI hopes to eventually operate on a sustainable basis without donor funding, but this is likely to require much greater maturity of the local market.

4. Client feedback/community involvement:

FI collected feedback from ECRA residents on a regular basis through the BDCs and constant contacts within the community. Staff engaged in frequent discussions and coordination efforts with municipal officials, as well as with local SMEs and residents to determine how community needs could be addressed by FI technical assistance efforts. During the last month of the program, FI conducted a follow-up survey of selected project beneficiaries in order to gain a better understanding of the impact the assistance had on their lives. FI also invited our major clients to tell us their impressions in a letter telling FI of both good points and bad regarding the assistance delivered. The letters and surveys were intended to provide a record that would help FI guide the development of new programs in the future. FI estimates that between 600 and 800 individuals, organizations and SMEs provided client feedback during the course of the program.

Client feedback on FI activities has been overwhelmingly positive. One-on-one contacts with clients indicated overall satisfaction with the assistance delivered and over 50% of clients repeatedly sought assistance from FI's BDCs. In fact, a large proportion of the indicator results presented were identified when clients contacted FI staff with the good news of a loan contract finalized or other positive results. FI's (selective) follow-up survey also suggested that clients were satisfied with results (TABLE 6). 20 individuals surveyed are SME and cooperative managers and were asked to rate their level of satisfaction with FI services and also their perceptions of how conditions have improved on a scale of 1-10 (from *least agree* to *most agree*). All indications of this survey were strongly positive. Overall satisfaction was on average 9.4 out of 10, and when asked to compare FI assistance to the assistance delivered by other programs, indications were also positive. There are also indications that FI's ECRA assistance program improved the responsiveness of local governments to business needs.

In general, businesses indicated that their competitiveness was strongly improved by FI assistance and that they have increased access to financial inputs for investment. In addition, of the 10 enterprises that reported adding new employees since first becoming an FI client, over 87 percent of these new employees were directly attributable to FI assistance. On average, 3.2 employees were hired during FI's program of assistance.

TABLE 6: Feedback Survey Results

	Avg
I am satisfied with the level of assistance that FI has provided to me, my employer or my family	9.4
When I think of other organizations that have provided support over the past several years, FI's assistance has been much more helpful to improving my economic situation	9.55
FI helped my business to become more competitive	9.05
Due to FI's help, my ability to access sources of financial inputs has been greatly improved:	8.75
Due to FI's help, I am more likely to hire additional employees during the next 3 years	7.9
Due to FI's help, I feel that the local and Croatian governments understand my business needs	7.85
Due to FI's help, I feel that I have better access to important business information (about loans, etc.)	8.75

5. Other programs or services of implementing partner in same municipalities:

None.

6. Partnerships, coordination, and leveraging of community-based resources:

FI achieved substantial gains for local community residents by partnering with other organizations and leveraging FI expertise with their resources and experience. Below we briefly describe a sample of the most significant of these:

Agro-Natur Cooperative: The Cooperative in Dvor served as FI's partner in the LCP in the Dvor and Kostajnica areas. It has played a key role in procuring animals and in providing feed and veterinary services to the LCP recipients.

Arbeiter-Samartarian Bund (ASB): The ASB-FI partnership generated significant benefits for the inhabitants of the ECRA area. FI provided a ground presence and technical feasibility studies to help ASB identify and evaluate business projects that could sustainably benefit from ASB construction assistance and would be otherwise ineligible for loan funds.

Croatian Ministry of Agriculture (Organic Farming Department): The Organic Farming Department of the Croatian Agricultural Ministry partnered with FI in certifying LCP pig producers with domestic certification. They also provided guidance to Drniš pršut processors to facilitate the PDO registration process and ensure that animals were slaughtered in accordance with these specifications. Additionally, the department assisted with organic certification for vegetable producers in Kistanje.

DEMOS SLC: FI established a firm partnership with the DEMOS Savings and Loan Cooperative, which included a number of joint FI and DEMOS loan activities in the context of the FI LCP. FI had a formal agreement, in accordance with our MOD 02 and MOD 04 proposals, to "hand-off" the LCP loan program funds to DEMOS before the end of the FI mandate. This handover has been completed. During the last year of program activity, FI and Demos shared office space in Drnis, which enabled Demos to build on FI experience in the area, thereby reducing client default risk.

Lutheran World Federation (LWF): FI and the LWF jointly developed milk collection projects since early 1999 and continued the cooperation under ECRA. FI successfully facilitated an expansion of LWF program into ECRA areas and made certain that cow donations were linked to a sales relationship with the Zagora Agricultural cooperative or other processors to ensure that farmer income resulted from the donations.

Privredna Banka Zagreb (PBZ), Postanska Banka and Splitska Banka: FI developed strong partnerships with these banks in order to help develop new loan programs and facilitate access to finance for ECRA residents.

SYNI-21 program: In accordance with a formal partnership agreement, FI arranged for a number of long-term consultants from the SYNI-21 organization in Lausanne, Switzerland. These consultants provided extremely valuable experience and technical knowledge to support FI field staff during the implementation of the ECRA program. In particular, consultants provided valuable support on projects in agriculture and tourism sectors.

UNDP: UNDP/UNOPS provided assistance to agricultural producers in Šibenik and Zadar Counties to become certified organic producers. FI coordinated with the organization to assist farmers in ECRA municipalities to converting to organic farming methods, and also helped organize the Eko-Dalmacija Agricultural Cooperative of Kistanje.

7. Changes to program design and implementation and reasons for these changes:

Mercy Corps approved FI's application as ECRA Sub-grant CR-02 in October 2001. The sub-grant provided funding for the delivery of firm-level technical assistance and coordination of community projects in the municipalities of Donji Lapac and Kistanje, with an office located in Drnis to coordinate activities. Subsequent to this original award, Mercy Corps approved five budgetary modifications to expand FI operations to the ECRA municipalities of Dvor, Drnis, Hrvatska Kostajnica, Obrovac and Pakrac and to augment operations with a Livestock Credit Program, additional consulting services for special economic assessment projects, and extended monitoring time at the close of the ECRA Program.

Budget Modification 01 (Approved: March, 2002) – FI was awarded additional funding of **USD 36,828** for the period from April 1, 2002 through May 31, 2002 for the purpose of completing a "Revitalization Analysis of Wood Processing Facilities in the ECRA Municipalities of Croatia." The additional funds were required to fund a temporary increase in staffing and additional travel required to complete the analysis.

The analysis demonstrated limited potential for the wood processing sector to significantly contribute jobs and income to ECRA municipalities. It also revealed that a slow privatization process would continue to prevent the restarting of the larger state-owned (or formerly state-owned) wood processors in the intermediate term. FI's report included a host of recommendations to the Croatian Government that would enable these large enterprises to resume operation. To date, the government has not reacted to these suggestions and these enterprises still are not functioning.

FI has remained dedicated to supporting the revitalization of the wood industry in Croatia, although our efforts have shifted attention from the large formerly state-owned processors to SMEs that have always operated privately. As of the close of the ECRA program, FI has worked with a family-owned wood processor that does not face the same legal, ownership and privatization problems as the large-scale state-owned firms. With FI assistance, this SME has resumed year-round timber processing and has added several employees to its Donji Lapac production facility.

Budget Modification 02 (Approved: May, 2002) – Mercy Corps approved supplemental funding of **USD 961,866** to expand the delivery of its technical assistance and community development activities into the municipalities of Obrovac and Drnis. As part of this supplemental funding, FI allocated **USD 270,000** to the implementation of a Livestock Credit Program (LCP) that helped promote revitalization of ECRA community livestock herds that had been decimated during the war. The LCP specifically enabled ECRA agricultural producers to bring their sheep and goat herds to economically sustainable levels so that these flocks would serve as a stable source of income for a family-operated small farm enterprise, and created positive cash flow so that the families could finance additional flock expansions in subsequent years. Originally the LCP was proposed for to expand cattle herds, but an import ban on cows made it impossible to obtain livestock of the quality that would be required for the program to succeed.

Budget Modification 03 (Approved: September 2002) – Budget Modification 03 provided authorization for FI to conduct a livestock market assessment in Gvozd. This was a no-cost modification.

Budget Modification 04 (Approved: February 2003) – Mercy Corps approved Budget Modification 04 in order to finance an expansion of LCP activities into the ECRA municipalities of Dvor, Hrvatska Kostajnica and Pakrac. **USD 77,685** in supplemental funding was approved and an additional sum of the existing FI budget was reprogrammed in order to support this project.

The funds were used to procure 810 high-quality domestic pigs and distribute them to pig breeders in ECRA municipalities in Banovina and Slavonia. The purpose of the program was to contribute to the economic development of both the northern ECRA municipalities (Dvor, Hrvatska Kostajnica and Pakrac) and the municipality of Drnis by establishing a market linkage between the pig breeders and the members of the Drnis Prsut Association. By providing short-term financing to pig breeders the LCP enabled them to raise the domestically bred pigs to the precise weight specifications required in order to be used by Drnis Prsut Association members as raw materials in the development of a premium pršut product. The project provided income and employment for 28 members of the Agro-Natur and Bagen pig breeders cooperatives. The program also greatly benefited the Drnis Prsut Association members by: providing a partial resolution to their previously problematic raw materials procurement; facilitating their shift to a premium product; and paving the way for the Association to acquire the essential PDO geographical protection that prevents competitors from falsely labeling their product as Drnis Prsut.

Budget Modification 05 (Approved: October, 2003) – Budget Modification 05 enabled FI to extend the monitoring period for the pig breeder LCP in order to oversee the slaughter of pigs and sale of pork to the Drnis Prsut Association and monitor the payments of LCP beneficiaries to DEMOS. In addition, it allowed FI to provide additional support to DEMOS during the savings and loan cooperative's expansion into additional ECRA municipalities.

8. Problems Encountered and strategies to address those problems:

FI projects have demonstrated remarkable success in generating jobs and income for the economically-depressed war-affected ECRA municipalities. Efforts included direct support to SMEs in order to accelerate business growth; increased market linkages and business opportunities for the SMEs have created additional employment opportunities for other entities with which SME's conduct business deals.

Although FI's program has achieved significant gains in improving conditions for residents of ECRA municipalities, many issues that have consistently impeded the pace of economic progress in these communities were beyond the scope of the ECRA Program. In this section, we sketch several major problems affecting the development of market driven activities in war-affected municipalities that could not be fully addressed within the framework of the ECRA Program. The issues broadly relate to property rights and rural/agricultural finance. While individually complex for historical, institutional and economic reasons, all of these issues tend to have a common impact on development: they inhibit and often prevent profitable business investment. The problems are generally not exclusive to war-affected or economically depressed areas, yet the repercussions are particularly severe in such municipalities due to the complex web of problems in these rural parts of Croatia.

The foregoing discussion is based not only on FI's efforts during ECRA, but on 7 years of experience working in war-affected regions of Croatia. We do not provide a discussion of strategies to address these issues per se; however, FI strongly believes that assistance strategies aimed at delivering support to enterprise growth in Croatia's war-affected areas must address the following problems:

9.1. Property rights –

Property rights remain ill defined in Croatia and there has definitely been a lack of adequate attention to resolving property-related issues. Broadly speaking, several of these factors impairing private sector development were mentioned in the World Bank report 22633-HR in August 2001 and have still not been adequately addressed.

9.1.1. *Privatization of State-Owned Enterprises*

The formerly state-owned and operated industries located in Croatia's war-affected regions were often motivated more by political concerns than by a desire to build financially sustainable operations. Some of these entities have very little hope of ever restarting; for example, an aluminum processing facility near Obrovac is so far removed from a source of raw materials that procurement costs are completely prohibitive. Yet, there are many promising formerly state-owned enterprises located in ECRA and other economically depressed areas that have excellent market potential and could be relatively quickly actuated to resume profitable operation.

Unfortunately, the Croatian Privatization Fund has not developed or executed an adequate mechanism for the resolution of the ownership status of the assets. Many facilities are currently not in use and/or are mired in legal limbo. A persistent problem has been a mechanism that allows for the acceptance of bids by individuals that do not have the financial resources required to complete the transaction. In many individual cases, tenders have been won by entities that have not fulfilled their obligations after winning due to lack of funds. This typically results in a virtual restarting of the entire tendering process from the beginning – a process that often ends in the very same way as the previously failed solicitation. It is not uncommon for the same individual/entity to win the bid in subsequent solicitation rounds and repeatedly fail to fulfill contracted terms. The resulting delays in privatization of the assets often reduce interest on the part of serious investors, decreasing the value of the asset in subsequent tenders.

We note that in some cases, the problems are political in origin. Insufficient transparency during the course of privatization has funneled assets into political cronies that have insufficient resources, knowledge and/or interest in restarting the enterprises. These individuals prefer to maintain control over a non-functional asset than to explore other options that could lead to the resumption of profitable productive activities.

FI has encountered these difficulties in a few sectors during the course of our efforts to restart business activity in ECRA municipalities. Several major examples include:

- **Wood Processors** – as part of budget modification 02, FI conducted an extensive analysis of the Croatian wood processing industry. While significant potential existed for the profitable resumption of activity, FI found that significant challenges existed to restarting the enterprises as a result of a poorly managed privatization process and a lack of effective means for companies to dispose of non-performing assets. FI maintains that the wood processing industry has significant potential to add jobs to the war-affected areas, although there has been little activity to resolve these problems that inhibit a resumption of productive activity.
- **Prsut** – Although it would be difficult to resume full-scale operations at Drnis's damaged Mesopromet prsut production facility, there has been international investor interest in purchasing the asset, which once employed hundreds of Drnis residents.
- **Vineyards** - Dalmatia has excellent climate conditions a strong tradition of wine production. Unfortunately, existing private vineyard space is too small to merit consideration for commercial-scale production. Larger scale state-owned blocks of land exist and have been

used in the past for commercial production, but this real estate has not been successfully privatized and much of it remains idle.

Our conclusion is that the privatization process has not paid sufficient attention to and is not sufficiently sensitive to economic conditions existing in Croatia's economically depressed regions. While it is true that the mechanisms developed have demonstrated mixed results in Croatia as a whole, the relatively limited economic opportunities that exist in ECRA municipalities mean that the jobs that could be created through the productive use of these assets is particularly hard felt.

Privatization is well outside of FI's scope of activities under the ECRA Program, yet our field experiences recounted above lead us to make the following suggestions that would help to improve results:

- ***Bidder Selection or Prequalification Mechanism*** – ineffective bidder prequalification has resulted in open tenders being won by entities that have insufficient resources to complete the transaction as described in their bid. This problem could be alleviated by requiring a relatively large payment to be submitted along with the bid (subsequently refunded to entities that have lost bids).
- ***Stronger contractual agreements and enforcement*** – Often an initial payment is made, but subsequent conditions or payments are not fulfilled. More detailed contract mechanisms should be developed and strictly enforced.
- ***Better mechanisms for dividing assets and disposing of non-performing assets*** – most state-owned companies are a monstrous collection of assets both with profit potential and without any hope of being used in productive activity again. Many enterprises are saddled with huge debt obligations. When lumped together in a single privatization offer, investor interest is often severely reduced. In order to achieve resolution of the assets in a way that leads to the resumption of productive activities and contributes jobs to the Croatian economy (especially in economically depressed regions), it is necessary to devise a privatization process that is conducive to investment. Offering assets in smaller, specialized blocks (e.g. according to function: land, production facility 1, production facility 2) and reassessing the process by which debt obligations are assumed and written off, could improve the attractiveness of these assets and greatly accelerate the resumption of productive activity.
- ***More effective appraisal of assets*** – in many cases, assessments of state owned property appears to have been faulty. Sadly, it appears that the overall commitment to resolving assets in war-affected areas is weak and as a result, a lack of professionalism exists during the privatization of these assets. In some cases, wage arrears or slow employee payments by organizations consulting on this process has significantly undermined motivation to conduct this work effectively.

9.1.2 Real estate ownership records

The issue of property ownership and records relating to Croatian real estate might justifiably be termed a catastrophe. Many of the records that do exist are from the 19th century. The process for determining or resolving ownership is so complicated that nearly every Croatian citizen seems able to recount a story of a loved one that has documents claiming ownership of property that their family has lived in for generations – records that are not considered valid by the Croatian legal system. It is not unusual for several different data sources to have conflicting information relating to ownership of particular pieces of property. As a result, the process for transacting real estate is costly and time consuming, sometimes taking several years and requiring expensive court proceedings that the average citizen can not afford.

The situation is particularly severe in war-affected areas. In many municipalities, land ownership records were completely destroyed during the war, further complicating an already difficult legal procedure to resolve ownership. Though this problem has provided significant challenges for a number of our ECRA clients, a recent example of this problem relates to the Lika Agricultural Cooperative of Donji Lapac. With FI's help, the Lika Cooperative and its members qualified for a loan from Postanska Banka valued at over **USD 500,000**. Despite ostensibly having sufficient collateral to secure the loan, members were required to submit land records to the bank in order to complete the transaction; however, these land records were destroyed during the war. Although FI was finally able to negotiate alternative terms that were acceptable to the bank, the process of completing the transaction is ongoing, requires a substantial financial outlay, and will take several more months before it is ultimately completed. In fact, when completed, the nearly one year long process will not provide permanent resolution of property ownership for members, but will merely satisfy the bank's requirements. Full resolution of the property ownership issue for members residing in this small municipality under the current system is estimated to require a minimum of 2 years and a substantial financial outlay (in larger municipalities this process can take 3-5 years). As municipality of Donji Lapac currently does not have a functioning court, members could not even start this long process.⁷

Land ownership record issues provide an enormous barrier to private investment in the Croatian economy. Two major problems caused are:

- **Bank loans are difficult or impossible for local investors to obtain** because they can not mortgage property for which the ownership is in question. (As per the example of the Lika Cooperative). This problem also helps to draw capital almost exclusively into small scale consumer-based leasing (e.g. automobiles) where a purchased asset can be used as collateral to secure the lending product.
- **Identifying investment locations becomes problematic.** Larger scale investments (e.g. hotels, manufacturing facilities, large scale agricultural producers, etc.) often require a large plot of land for the conduct of business. Because there is no regular, established and credible mechanism for identifying and transacting property, many investors have turned away from opportunities in Croatia because they do not believe that they would be able to legally purchase a plot of land needed to conduct business.

Current government and donor efforts related to this issue seem focused on developing an extensive digital mechanism for the efficient transacting of property. While the joint WB/CARDS-funded project ("Modernization of Land and Cadastre Registry") provides a commendable long-run vision for the future transaction of land in Croatia, the completed exchange mechanism will only function properly in cases where the land and ownership records are complete. The chaos embedded in the existing land record data and the lack of attention to resolving the issues means that it appears that for the foreseeable future only a tiny fraction of real estate in Croatia would qualify to be transacted using the system. To date, the limited guidance that has been provided to the Croatian Government relating to the resolution of property rights has been: ineffective in providing adequate examples of best practice on the local level; not translated into either a generalized solution or a sense of urgency on the policy level; and has not made an effort to address issues faced by ethnic minorities, refugees or residents of war-affected municipalities.

⁷ Without a functioning court, legal proceedings for the municipality of Donji Lapac are covered by the court in the municipality of Korenica. While technically possible to start the legal process to obtain complete land ownership documentation through this court, the current case burden on the legal system appears to substantially deprioritize matters from Donji Lapac. Legal council advised FI not to consider pursuing resolution of the problem through this route.

9.2 Agricultural and Rural Finance

Any serious effort to promote investment and job growth in economically depressed, rural areas of Croatia needs to include measures to support non-bank lending. As articulated above, many rural and war-affected areas have no land records and cannot collateralize loans. Even in cases where land records are available, the real estate collateral offered to banks by individuals and firms is typically not regarded as valuable enough to secure loans of the desired size from private banks. Moreover, banks are generally not interested in lending in economically depressed areas of Croatia, both because of the lower return and higher cost structure for lenders providing small loans in rural locations, and because the uncertainty of contract enforcement makes them skeptical that repayments will be made.

Agribusiness opportunities are particular and often loan products designed to meet their needs. In particular, agricultural investments are highly dependant on climate conditions, which can create disasters for lenders specializing in this sector. For example, repayments to FI's LCP portfolio were significantly delayed by an unusually wet winter followed by the "worst drought in Croatia's history,"⁸ which stymied lambing rates, stunted lamb growth and lead to animal mortality rates as high as 60% of herds. Commercial lenders tend to be insufficiently tolerant to such climatic risks. Furthermore, the very nature of agricultural lending is incompatible with the profit structure of most commercial lenders. Traditional pršut producers, for example, must purchase raw material inputs 1-2 years prior to the eventual sale of finished dried pršut. Financing these raw materials with cash alone is expensive for pršut processors and severely limits their ability to expand production to full capacity. Commercial lenders are often reluctant to develop products that are suitable for the production cycle cash flow situation of such producers. These credit problems affect entities at all stages of production, from the production of raw materials to the sale of the final product.

To help address these problems, FI has persistently supported the organizational development of DEMOS SLC, which is trying to develop loan products that are consistent with the cash flow and collateral problems specific to Croatia's economically depressed areas. FI strongly recommends that Demos continue to receive financial support from the international donor community as it grows into a sustainable financial services organization. We also recommend that DEMOS ultimately diversify its product line (beyond its primarily agricultural focus), in order to develop products that better enable the organization to hedge risk and reduce the cost of lending for its clients.

9.3 Livestock Markets

During the ECRA Program, FI developed feasibility assessments and recommended small-scale livestock markets in Donji Lapac, Kistanje and Obrovac requiring investments of approximately **USD 15-18,000**. Subsequent negotiations involving the construction contractors, municipalities and USAID resulted in the decision to fund markets at total investments of **USD 100,000**, with a municipality cash contribution for the completion of the market exceeding the total investment cost originally recommended by FI. This decision was made ostensibly at the urging of construction contractors and over recommendations repeatedly made by FI to USAID and MCI not to fund such large investments.

⁸ Earthweek: A Diary of the Planet, by Steve Newman, May 16, 2003: Earth Environmental Service.

Currently, the livestock markets in Obrovac, Kistanje and Donji Lapac are not complete or functioning. The cost share contribution expected from the municipality of Kistanje is well beyond the budget of the municipality and it is extremely unlikely that the municipality will be able to raise the resources required to put the market in working order within the foreseeable future. Nevertheless, at USAID's request, FI has provided management plans to guide the municipalities in the operation of facilities in the event that resources are identified to complete construction of the market.

10. Lessons Learned

10.1 Forward Contracts

The creation of long-term and *contracted* market linkages was an important and valuable component of the assistance strategy developed by FI. The intention was to ensure that increased production volumes were matched with increased sales in order to provide an incentive for investment and growth. *Forward sales contracts* make it easier for agricultural producers to specialize in production and be assured of a given price at the time the product is ready. Although at times, the short-term revenues from these contracts are less than the farmer can earn by negotiating individual sales on a one-on-one basis with clients, forward contracts enable the producer to earn a higher profit over the long run. This is because processors will pay a premium for the certainty that quality products that are delivered according to contracted specifications, and small-scale producers waste less time and money driving around the region to negotiate one-on-one deals with small-scale buyers. FI clients that have accepted forward contracts have benefited greatly in terms of the income realized and retained. This is especially true of Zagora cooperative members, who earn *daily* income from the sale of milk to I-Pak. Other clients, specializing in meat products or crops that are only sold once or a few times per year, are less likely to accept forward contract arrangements. This is because these families are so dependant on these one-time income sources that their fear and uncertainty regarding getting the most money often motivates them to hunt for the best price at the time of sale, despite the fact that they spend more in gas when finding a sales market than they gain in a better price. Large-scale processors are unwilling to negotiate contracts with these producers, because they are often renege on at the time of delivery. Although these one-on-one negotiations remain the norm for agricultural producers in economically depressed areas, FI assistance has provided valuable examples of a more effective way of doing business through forward agreements. For cow owners that earn a daily income from milk sales, the immediate effect of the contract agreement on their daily income provides a strong motivation for farmers to work through this type of structure.

10.2 Market Linkages

Another important lesson learned is the general effectiveness of FI's market linkage-finance facilitation approach. The approach enabled FI to exceed each performance indicator variable by a comfortable margin (at least 14% over target). Many programs that have focused solely on expanding productivity in the region have been hurt considerably by the failure to examine markets and ensure that a sales linkage exists.

10.3 Community Assistance

In general, FI believes that the umbrella grants mechanism of ECRA worked well. The umbrella grants scheme enabled implementing partners to specialize in the delivery of services in an area of expertise, which was helpful in preventing implementers from becoming bogged down in competing programmatic areas while trying to solve the complex problems affecting local communities.

11. Additional Information:

Please See Appendices.